



Bulletin

2006-05B

BUREAU OF ACCOUNTS ANNUAL BUDGET BULLETIN

TO: Mayors and Selectmen City and Town Managers
 Boards of Assessors Executive Secretaries and Finance Directors
 Auditor and Accountants City Solicitors and Town Counsel
 Collectors Regional School District Committees
 Treasurers Regional School District Superintendents

FROM: James R. Johnson, Director of Accounts

DATE: March 2006

SUBJECT: FY07 Budget Issues

This *Bulletin* addresses issues cities, towns and regional school districts may consider in development of budgets for FY07.

School Building Payments

Beginning late in 2004, the Massachusetts School Building Authority ("MSBA" or "Authority") began payments and audits of school projects pursuant to Chapter 208 of the Acts of 2004. In the FY06 tax rate forms and instructions, we defined a separate line on the tax rate recapitulation form (III. A. 2) for the city or town to insert the estimated reimbursement from the MSBA and a form to itemize the amount by project, with estimates reflecting the audit results. The process, in the vast majority of cases, worked well. Of course, the MSBA indicated, in a transitional process, that it would hold cities and towns harmless if audits completed during FY06 resulted in a reduction of estimated FY06 payments. For FY07, the MSBA has indicated that it will again hold cities, towns and regional school districts harmless for audits completed after February 22, 2006. Please refer to the MSBA's web site for a listing of FY07 estimated payments. The MSBA intends to post this information on its web page on or about May 15, 2006 (<http://mass.gov/msba/>).

The Division of Local Services is responsible for oversight of and assistance to cities and towns in achieving equitable property taxation and efficient fiscal management. The Division regularly publishes IGRs (Informational Guideline Releases detailing legal and administrative procedures) and the Bulletin (announcements and useful information) for local officials and others interested in municipal finance.

In planning for fiscal year 2007, please refer to a February 2006 letter that was sent to city and town treasurers and regional school districts from the MSBA announcing that it would be accelerating payments to cities, towns and regional school districts with projects on the Waiting List. For those communities on the Waiting List who were originally scheduled to be paid in FY2007 or FY2008, the Authority may now be able to make a payment in calendar 2006. Please pay particular attention to the items listed in the letter as they relate to reimbursements for projects on the Waiting List. A copy of the February letter is posted on the MSBA's web page.

In addition, the MSBA has informed us that they are able to expedite audits for all completed projects. Please contact the Authority to schedule your audits. The MSBA has indicated that all outstanding audits must be scheduled in order for a district to be eligible for future grants.

These estimates are often a large amount, and require careful effort on the part of the city or town treasurer regarding maturity of temporary financing, issuance of notes pending, determination of further MSBA grants after conclusion of the construction cost audit, determination of bonds to be issued by the city or town, and other issues. Effort of the auditor or accountant and school personnel regarding completion of the construction cost audit is also critical. As stated above, the process worked well in the majority of the cases in the FY06 tax rate approval process, but we are still in a transition process, so I advise that this matter be afforded high priority to insure the best revenue estimates in the FY07 tax rate process.

Self-Insurance Plans for Employee Health Insurance

Over seventy cities, towns and other entities operate self-insurance plans for financing employee health insurance under provisions of Chapter 32B §3A. Last year, Chapter 61 of the Acts of 2005 amended the General Law to require (1) that an annual audit of such plans be completed (which may be part of the annual audit of the city, town or other entity), (2) that so-called "incurred but not reported" or "IBNR" claims be recognized, and (3) that any deficit in the fund be provided in the next annual tax rate of the city or town or in the next fiscal year's budget for any other entity. The Act provided a waiver relative to any deficit attributable to failure to have recognized IBNR claims as of June 30, 2005; such a deficit may be capitalized and funded over a three-year period beginning in FY07. Determination of this amount, which could be substantial, is necessary at this point in the FY07 budget process.

A schedule to document this amount, which will be similar to that for the "Teachers' Summer Pay Deferral" in 1992 (which is still being amortized until 2011) will be included in the Tax Rate Forms and Instructions package to be released in July.

Reimbursement of Special Education Costs by Department of Education

The current program was established to reimburse city, town and regional schools for extraordinary and volatile special education costs. Our *Bulletin* 2004-06B issued March 5, 2004 was based on assumptions and revenue estimates at that time. Special Education costs would be charged to the general school budget; quarterly distributions by DOE would be deposited in a special revenue fund, and eligible special education costs would be charged to the special revenue fund. Other things being equal, the school budget would revert monies to the city, town or a regional school district's "excess and deficiency" fund.

Since then, the state Department of Education has been able to reimburse a higher amount than anticipated. Some schools then left more of the special education costs in the general school budget, and allowed the special revenue fund to accumulate amounts, in some cases substantial amounts.

Some certified public accounting firms cited this DOR *Bulletin*, and argued that the transfer of costs to the extent of the DOE distributions credited to the special revenue fund was mandatory, with the result

that a reversion from the general school budget would increase free cash in a city or town or the E&D fund in a RSD. DOE has generally agreed with the approach of the local school department. In addition, the FY06 state budget¹ changed the reimbursement method to base the calculation on costs of the prior rather than current year. We understand that DOE is studying this issue and may define a limit on the amount that may be accumulated in the special revenue fund.

At this time, consistent application of rules does not exist. However, if a substantial amount has accumulated in the special revenue account over the years, its existence may be a matter for discussion in formulating the funding level of the general school budget for FY07.

Community Preservation Fund

Over 100 cities and towns have adopted this option by referendum. Based on the balance in the State Fund from surcharges at the Registries of Deeds, we expect that the matching funds to be awarded in October 2006 will again be equal to 100% of the surcharge levied by the city or town in FY06.

I must point out, however, that the payments made in October 2005, for the first time, exceeded the collections at the 21 Registries in the prior year. This results from (1) falloff in the number of deeds and related transactions, (2) increase number of cities and towns participation and (3) the fact that the surcharge amount at the registries is fixed while the surcharge levied by the city or town increases each year due to the 2½% increase in the tax levy, the tax value of construction taxed for the first time, and the amounts of any overrides or debt exclusions approved by voters.

As a result, the duration of the matching funds continuing to equal 100% of the city or town surcharge revenues is uncertain.

Regional School District (“RSD”) Use of “Excess and Deficiency” Fund

Chapter 71 §16B½ governs the “Excess and Deficiency Fund” (“E&D”) of a regional school district; the fund is not dissimilar to “free cash” in a city or town. The amount is to be certified by this office, using established accounting principles relative to balance which flow to fund balance versus those balances properly encumbered or reserved. The amount may be used as a partial funding source in the next year's assessments to member cities or towns. An amount in excess of 5% of the budgeted operating costs and budgeted capital costs of the succeeding fiscal year must be applied to reduce assessments to member cities in towns in the succeeding fiscal year.

We understand that assessments of certain RSDs have been computed with estimates of E&D not certified by DOR. E&D as of July 1, 2004 was certified for only 53 of the 84 RSDs statewide; to date, E&D as of July 1, 2005 has been certified for only 41 RSDs. We must advise of this statutory requirement, since the amounts in the resulting budgets and assessments can be substantial.

Non-recurrent Distributions to Cities and Towns

General Laws Chapter 44 §53 provides that funds received by a city or town shall be applied to the general treasury, and thereafter flow to fund balance and “free cash,” and be subject to appropriation. We are often presented with questions relative certain non-recurrent distributions, and whether the “free cash” approach applies, given the one fiscal year lag that results in potential use of the funds. Recently such questions have arisen relative to distributions from (1) the New England Solid Waste Energy Collaborative (“NESWEC”) which had agreements with about 25 cities and towns and recently concluded its operations, (2) a regional vocational school district which received a lump-sum payment from the School Building Authority including costs which had essentially been pre-billed to about 15 member towns to level-off

1 Chapter 149 §128 of the Acts of 2004.

capital assessments since state building reimbursement was not expected until principal payments on bonds had begun, and (3) state agencies or developers for payments under certain contracts.

We recognize that these are not usual fee revenue of the city or town, and may be analyzed on an individual basis. Requests for such review will be considered under these criteria:

- submission of copy of the award or contract,
- options of the city or town if the amount will not equal obligation of the city or town.

In such cases, we will consider reservation of the income for the period of related costs over a multi-year period, or other disposition. Such request should be submitted well in advance of the tax rate recapitulation form.

Electric Operations of Cities and Towns –Audits

Many of the approximately forty cities and towns which operate municipal electric plans under provisions of Chapter 164 retain an independent certified public accountant to audit their electric operations, other than the firm which performs the city or town audit. One reason may be that the electric plants operate on a fiscal year ending December 31 as opposed to the municipal fiscal year which ends June 30. The electric results are then included in the audit of the city or town as a “component unit” relying on the opinion prepared by the other firm.

In such cases, the audit report for the electric operations must be filed with the director of accounts, as required by provisions of Chapter 44 §42. The notification of engagement of the firm is also required under the same section.

Certification of City, Town, District and Regional School District Notes And Receipt of Audit Reports

Audit Reports of cities, towns and districts are required if receipt of federal funds exceed threshold amounts promulgated by the federal Office of Management and Budget. Audits of regional school districts are required under provisions of Chapter 71 § 16A. In recent years, concerns have arisen as to certification of “State House Notes” under provisions of Chapter 44 §§23-27 in the absence of current audits of issuers of the notes. Effective with certification of notes in FY06, we have consistently not certified revenue notes of a city, town, district or regional school district if a required audit is not submitted within year of the period covered by the audit, e.g., if the audit for the period ended June 30, 2005 is not submitted by June 30, 2006. This practice will continue.

Enterprise Funds – Allocation of Indirect Costs

Costs incurred in general fund departments to support enterprise activities may be allocated to the enterprise fund, if computed on a fair and consistent basis, and documented properly. In recent years, cases have arisen relative to allocation to an enterprise of costs incurred in prior fiscal periods, due to delays in beginning the enterprise's operations at the start of the fiscal year, or similar reasons. We feel that while such cases may have merit, that restoring payments to the general fund should be subject to reasonable limits.

Effective with approval of the tax levy and tax rate for FY06, no reimbursement of indirect, startup or allocated costs from a period greater than two prior fiscal years prior to the year at issue will be recognized as costs of the enterprise. This practice will continue.

Storm Expenses of October 2005

Based on declarations by the President and Governor, the Federal Emergency Management Agency and the Massachusetts Emergency Management Agency in Framingham are considering applications from

cities and towns for reimbursement of qualifying expenditures incurred following these storms. Consistent with past practice, if the reimbursements are not received by June 30, 2006, we will allow accrual of the amount for which an application was timely submitted, and will not deduct the amount or require it to be raised in the FY07 tax rate pursuant to Chapter 44 § 31D if received prior to September 30, 2006.

About ten towns received approval for Emergency Loans under provisions of Chapter 44 §8 (9), following approval by the Emergency Board after hearings in Springfield or Boston. In each case, the town agreed that the reimbursements would be applied to reduce the principal on such loans. In those cases, only the principal and interest paid or to be paid in FY07 would need to be provided in the FY07 budgets.

Recording of Subsequent Year's Commitment of Real Estate and Personal Property Taxes

While the commitment for real estate and personal property taxes – particularly for cities and towns using the quarterly billing option with a bill due August 1 – may be prepared by the assessors during June to assure mailing of bills by the collector to ensure the enforceability of the August 1 payment date, the auditor or accountant should not record the commitment until the start of the new fiscal year. Much of the effort in preparing the unaudited statements, certifying free cash, and preparing the audited statements will be avoided if the commitment is not recorded until the year to which the taxes apply.

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Please contact your Bureau of Accounts field representative with any questions.